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Date: July 27, 1982

MEMORANDUM FOR: SECRETARY REGAN

From: Assistant Secretary Leland

Subject: Report on IG on U.S.-EC Relations; Suggested Agenda for Wednesday's SIG

The IG recommends that the SIG discuss the following issues to prepare for discussion of U.S.-EC relations on Friday, July 30 with the President at the NSC:

1. State of U.S.-EC Relations. What type of response does the overall state of our relations with Europe require? Our relations are described in attachment 2. Possible views are:

- a. Relations are such that changes on both sides are needed to improve the relationship.
- b. The Europeans are angry, but that is to be expected; we should continue business as usual.
- c. Despite the state of relations, we should press harder to assert U.S. interests (agriculture, East-West issues).

The discussion might cover how to respond to European defiance of the President's sanction decision on the pipeline, the differences among the EC members on most issues (other than the pipeline), the economic malaise in Europe that invites using the United States as a scapegoat, and the European perception that the United States is aggressively pursuing its interests irrespective of European views or GATT rules.

2. Current Issues. What are they, which are most pressing, and how much freedom of maneuver is there? The immediate issue is our policy response to the Europeans going ahead with the pipeline. Steel is next. Option papers on steel, agriculture, and GATT Ministerial are at attachment 5.

The IG discussion revealed very little room for maneuver on most issues. These issues continue to be handled independently by the interested agencies, which oppose basic changes in current approach.

NSC review  
completed.

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- On steel, Secretary Baldrige will continue to seek an agreement acceptable to U.S. industry.
- On agriculture, there was disagreement on whether to reduce U.S. rhetoric, withdraw weak GATT cases, and seek a negotiated solution to EC export subsidies (accepting the EC's right to subsidize but trying to discipline it) or whether to start subsidizing our exports to strengthen our negotiating position.
- On DISC, the IG believed the Europeans had made DISC a symbolic issue of U.S. obstinacy, but the U.S. would be in an untenable position should the GATT rule against us, as is likely.
- On the GATT Ministerial, the IG felt the real options were whether to press on agriculture, and how hard to press for U.S. objectives in investment and high technology trade. However, U.S. concessions would have little effect on overall U.S.-EC relations.

3. U.S. Strategy. How should we structure our economic policy with Europe? The IG felt more work needed to be done on both substance and style.

-- On the first, we should develop, by the end of August, a decision package on key issues in U.S.-European economic relations for the President.

-- Based on those substantive decisions, we should decide on the most appropriate, effective followup -- ranging from our existing approach, to a more visible emphasis on high-level contacts, such as a senior mission to Europe, the convening of a U.S.-EC Ministerial this autumn, or an expanded mandate for a Cabinet officer to deal with U.S.-EC economic issues.

The attached papers provide background as follows:

1. Objectives of U.S. economic policy toward Europe.
2. Assessment of present economic relations between the United States and Europe and their implications.
3. Future decision points affecting U.S.-EC relations.
4. General approach in responding to the EC.
5. Option papers on steel, agriculture, and the GATT Ministerial.

Attachments:

As stated.

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**SECRET****1. OBJECTIVES OF U.S. ECONOMIC POLICY TOWARD EUROPE****I. General U.S. Goals**

- A. Protect most important U.S. economic interests.
- B. Prevent economic and trade disputes from undermining transatlantic cooperation on fundamental political and security issues.
- C. Pursue dialogue with the Europeans to contain economic problems and reduce tensions, after we have set our own priorities and identified areas for possible shifts in policy by the U.S. and Europe.

**II. Specific Issues****A. Macroeconomic Policy**

- 1. Convince Europeans that we are following a coherent strategy for controlling inflation and lowering budget deficits and interest rates.
- 2. Demonstrate that we are prepared to follow up on Versailles commitments on macroeconomic policy consultation and study of exchange market intervention.
- 3. Use action on 1 & 2 above to reduce Europeans' tendency to use the U.S. as a scapegoat for their failure to deal more effectively with their own economic problems.

**B. East-West****1. Sanctions**

- a. Maintain pressure on Soviet Union and Poland.
- b. In view of European decision to challenge pipeline sanctions, examine our legal options so as to preserve our credibility, while minimizing damage to our future commercial prospects.
- c. Seek coordination on responses to July 22 announcements in Poland to prevent precipitous European action.

**2. Credits**

- a. Implement recent agreement to the OECD Arrangement on Export Credits to raise the cost of official credits to the USSR.

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b. Concentrate now on improving data collection and policy-oriented discussion in the OECD and NATO, including U.S. reporting.

c. Move later, using that information, toward setting up a Summit Monitoring Group.

3. Polish Debt

a. Prevent the Poles from making credible political arguments rather than economic arguments for their inability to repay their debts.

b. Coordinate decision with Allies on the July 22 announcement to block rescheduling at this time.

c. Avoid isolation from Europeans so that we do not lose leverage.

4. Long-Term Grain Agreement with the USSR

a. Preserve markets for our farmers and ensure decision on the Agreement that is consistent with other aspects of U.S. policy.

b. Resist European efforts to use U.S. grain sales as justification for go-ahead on pipeline and/or other actions.

C. Trade

1. Steel

a. Protect U.S. industry from injurious unfair trade practices, without unduly jeopardizing U.S.-EC relations.

b. Demonstrate that GATT Subsidy Code can work to increase market discipline.

c. Seek EC-wide settlement before October 8.

2. Agriculture

a. Encourage improved discipline on EC export subsidies.

b. Negotiate stronger GATT rules on agricultural trade.

c. Deflect EC efforts to force renegotiation of tariff bindings (corn gluten-soybeans).

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- d. Negotiate with the EC on problems of agricultural trade. This could involve a lowering of rhetoric and reexamination of policies on both sides (EC on subsidies -- U.S. on weaker GATT cases which have not yet gone to panel).

3. GATT Ministerial

- a. Obtain EC cooperation in pushing a broad agenda for strengthening the international trading system. Our priorities include initiatives on agriculture, services and trade-related investment, high technology and a North/South round of trade negotiations. (Many Europeans are lukewarm, at best, about the scope of our proposals and, on agriculture, actively opposed.)
- b. Consider whether sharpened emphasis on areas to which EC is now receptive (services, North/South round) can improve cooperation.

D. Energy

- 1. Accelerate efforts to develop credible energy security program, through U.S. domestic measures and efforts in Europe. (Under Secretary Buckley chairs an-Energy Alternatives Group which plans to present a package to the President soon.)
- 2. Continue to discourage undue European vulnerability to cutoffs of Soviet natural gas.

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**B. Differences in European Views**

In addition to keeping in mind the economic backdrop in considering U.S.-EC relations, we need to recognize the diversity of views in the European Community. The European Commission tries to lead, but often ends up bridging differences among states with a "least-common-denominator" position. While they may agree on some issues, there are huge differences on many issues of interest to us among leaders such as Thatcher, Schmidt, Mitterand, and Papandreou. Some of these differences, which often exist within governments as well, are described in the following discussion of current issues.

**C. East-West Issues**

There are fundamental differences between U.S. and European views of the proper response to the Soviet threat. Even if the odds are 90 to 10 that the Soviets can be brought to the bargaining table through economic sanctions -- and the Europeans do not believe the odds are nearly that favorable -- they consider the odds unacceptable. A 10 percent chance that sanctions will instead produce a cornered, dangerous Soviet bear is too high for them.

While they will not say so publicly, most European countries accept the division of Europe and feel Soviet policies are unlikely to be changed by economic measures. Therefore they might as well get the benefit of trade, jobs and income they otherwise would not have in sectors such as steel and agriculture.

The pipeline decision thus went against a basic European view. It also went against the views of individual countries:

-- Germany: While German leaders can't publicly accept the division of Germany, they also cannot oppose detente and risk losing contact with East Germany.

-- UK: Thatcher's response in Parliament was sharp because of strongly-held British views against foreign countries' assertion of extraterritoriality.

-- France: The pipeline decision touched the sensitive sovereignty nerve.

European opposition to extension of the U.S.-USSR Grain Agreement is also strong. They think we are willing to sacrifice European sales but are unwilling to sacrifice our grain sales because it would be politically unpopular. They think we impose more political pain on the Europeans than we are willing to take. They miss the point that sanctions hurt the United States, too. We made the decision recognizing it would hurt U.S. exports

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**2.(a) ASSESMENT OF PRESENT ECONOMIC RELATIONS BETWEEN THE UNITED STATES AND EUROPE**

The current tensions in U.S.-EC relations are the result of (a) fundamentally different views on policy vis-a-vis the Soviets, (b) long-festered trade disputes, and (c) coincidence of a series of U.S. decisions affecting Europe. These issues are made much more serious -- and reactions to them sharpened -- by Europe's economic malaise. Before formulating a policy response to the current situation, it is necessary to put these issues into perspective.

**A. Economic Situation**

While the current economic difficulties of the European economies seem similar to those of the United States, in many respects the European situation is worse, particularly in regard to jobs and outlook.

Unemployment in the EC has risen to historic levels in the last two years and threatens to stay at least that high. They view their unemployment as more structural than cyclical. While U.S. unemployment is also high, the American economy has created many new jobs in the last few years and the outlook is encouraging.

The differences in policy response, and in hopes for the future, are even greater. The European governments have more often yielded to the pleas of special interest groups for direct subsidies. Faced with economic stagnation and inflation, European leaders are pessimistic.

The European economic malaise strongly influences our relations. European leaders cannot escape the temptation to make U.S. policies the scapegoat for their own economic failings -- now castigating the United States for exporting unemployment (through too tight monetary policy), previously for exporting inflation (through too loose monetary policy).

European unemployment also makes European leaders hyper-sensitive to U.S. actions that cost Europeans jobs, as is threatened by the steel cases and pipeline sanctions.

The more aggressive assertion of U.S. interests, combined with the somber European economic situation, explains the sense of "crisis" in EC statements on current trade issues. But the issues themselves are old ones: EC steel exports have been a problem since the late 1960's (when we negotiated voluntary export restraints). The CAP has been a major element in U.S.-EC relations since the early 1960's -- but the adverse impact on our farmers has become steadily worse. And as to the third major trade issue, the GATT Ministerial, we have always had to lead trade liberalizing initiatives, pulling along a reluctant EC.

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immediately, and over the longer run. We also recognized it would encourage nationalists in other countries, as in Canada, who are trying to reduce dependence on the United States.

These fundamental differences in policy view, as well as opposition to the pipeline decision for different national reasons, means there is no leader in Europe who will speak for the United States on these issues in EC councils.

#### D. Individual Issues

Differences among EC members are sharp on several current U.S.-EC issues:

Steel: Completion of the countervailing and dumping cases will have widely different effects -- virtually eliminating from our markets British, French, Belgian, and Italian steel, while Dutch and German exports might increase.

CAP: The UK and Germany are critical of expenditures for exports, while France sees them as an essential benefit of membership in the EC.

GATT Ministerial: There is a large gulf between the German trade liberalizing approach and the French job protection view.

Export Credits to USSR: Also a West-West issue. The French subsidize to keep the Germans from getting the sales, not to help the USSR.

U.S. policies should recognize and take advantage of these differences and not assume the EC has one view. Without undermining such European unity as the EC represents, we should nevertheless work with these leaders who agree with U.S. on individual issues to take up our cause in EC councils. Well-handled, such an approach can strengthen rather than weaken the EC as an institution.

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## 2 (b) IMPLICATIONS FOR ECONOMIC, POLITICAL, AND SECURITY RELATIONS

U.S.-European frictions in the trade area are serious in their own right. Coming together, they heighten economic tension and may be troublesome for our broader political and security relations as well.

### Economic

The EC may be tempted to react to U.S. actions on the pipeline and steel by retaliatory actions in other areas: a tariff quota on corn gluten, a tax on vegetable oils and fats, retaliation against DISC if found in violation of GATT by the September GATT Council, a refusal to cooperate (or to attend) the November GATT Ministerial.

It is not clear that the EC would do any of these things. A continuing tense atmosphere, however, will inevitably make cooperation at the GATT Ministerial difficult and could jeopardize the achievement of a GATT work program on services, investment, high technology, and agriculture -- all key U.S. objectives.

### Political

Failure to address promptly the confluence of contentious economic issues in U.S.-EC relations could result in a further deterioration of U.S.-EC economic relations and ultimately jeopardize our political relationship with our Allies. It could play into Soviet hands by sharpening divisions in the Alliance.

While we see recent U.S. moves as an overdue and appropriate assertion of legitimate U.S. interest, the Europeans perceive recent U.S. decisions on steel, expansion of Polish sanctions, and Law of the Sea as indications of a new U.S. determination to act without regard for the interests of traditional friends and Allies. This perception could strengthen the hands of European advocates of a distinctly European approach to political/security issues, e.g., the Genscher-Colombo plan. Political disunity in the transatlantic community would jeopardize our cooperation with the Allies on East-West relations, the Middle East, Southwest Asia, the Caribbean, Africa and Southeast Asia. It would also jeopardize our pursuing common objectives on other important issues, e.g., Law of the Sea and nuclear non-proliferation -- especially where European commercial interests and relations with the Third World are concerned. The United States cannot hope to realize its objectives in these areas without the cooperation and support of our Allies.

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### Security

Current tensions in U.S.-European relations could also spill over into the security area. Our efforts to build a strong Alliance consensus on policies necessary to bring about Soviet

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restraint and responsibility could be damaged by Allied anger over economic issues, coupled with the perception that we are seeking to impose an "economic warfare" strategy on our Allies.

More specifically, the Allies could be less willing to make political or economic sacrifices to carry out key security initiatives or to cooperate on questions of priority U.S. interest if they believe we are insensitive to their own needs and concerns. Fundamental security interests remain unchanged, and the current strains do not yet threaten the Alliance. They do, however, weaken the spirit of mutual confidence on which effective Alliance consultations and action depend. These tensions may damage the NATO consultative process by encouraging the tendency of EC partners to consult, and even reach decisions among themselves on issues of direct concern to us and the Alliance as a whole.

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**CONFIDENTIAL****3. FUTURE DECISION POINTS AFFECTING U.S.-EC RELATIONS**

Key decision points which could add to the frictions in U.S.-EC relations between now and October are as follows:

Late July	<u>Grains</u> : U.S. decision on long-term grain agreement with the USSR. Any decision involving larger amounts is likely to add significantly to the frictions in U.S./EC economic relations.
August 9	<u>Steel</u> : Commerce preliminary findings in dumping cases against EC producers.
August 14	<u>Pipeline</u> : End of period of public comment.
August 24	<u>Steel</u> : Commerce final subsidy finding in EC cases.
Mid-August	<u>Autos</u> : Possible passage of local content legislation for autos which could exclude Volkswagen (FRG) from the U.S. market.
Aug./Sept.	<u>Agriculture</u> : GATT Director General Dunkel may attempt conciliation in U.S./EC citrus preference dispute following GATT Council's inability to agree on forming a panel.
Sept. 20	<u>Agriculture</u> : Working Party on the U.S. GATT waiver for agricultural programs (Section 22 waiver), possible forum for EC complaints about U.S. attacks on their agricultural system.
Sept. 21	<u>Agriculture</u> : GATT Article 22 consultations with the EC on corn gluten where the EC has threatened to withdraw tariff concessions of major importance to the U.S.
Sept. 23-24	<u>Agriculture</u> : GATT Article XXII consultations on sugar (tentative).
Sept. (date uncertain)	<u>Agriculture</u> : GATT panel decision in U.S. case against EC wheat flour subsidies.
Late Sept.	<u>DISC</u> : GATT Council review of DISC's consistency with GATT; the EC is expected to request authority to take measures to offset the effect of DISC.
Sept.	<u>Export Credits</u> : U.S. expects to begin negotiations with EC member states, and perhaps the EC, on export financing of aircraft.
Sept. 30	<u>Grains</u> : Expiration of current U.S./USSR grain agreement.

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Sept. 30      Agriculture: Deadline for interagency report in 301 case against EC poultry subsidies.

Sept./Oct.      Greek Accession: Continuation of negotiations with EC on tariff adjustments, primarily on agricultural commodities, following Greek accession.

Sept./Oct.      GATT Ministerial: EC likely to play passive role, hampering U.S. efforts to include agenda items on trade in services and investment as well as stronger rules for agriculture.

Sept./Oct.      Pipeline: European companies may ship pipeline related equipment covered by U.S. sanctions or face penalty clauses in their contracts with Soviets.

Oct. 4      Steel: Commerce preliminary determination in subsidy cases against welded pipe from France and FRG.

Oct. 8      Steel: USITC final injury determination in EC steel CVD cases.

Mid-October      Export Credits: Beginning of discussions with major participants on the outlines of possible improvements to the arrangement on Export Credits. France, not the EC, has resisted U.S. efforts to limit export credit subsidies.

Oct. 24      Steel: Deadline for recommendation to the President in 301 case on EC specialty steel subsidies.

Oct. 25      Steel: U.S.-EC final injury determination in EC steel antidumping cases.

Oct. 30      Agriculture: Deadline for recommendation to the President in Section 301 complaints on EC sugar policies.

Oct./Nov.      Maritime: Negotiations with the EC on the implementation of the UN. Code of Conduct for Cargo Liner Conferences. U.S. is asking EC members to suspend ratification process and join U.S. in opposition to cargo allocation schemes.

Oct./Nov.      Textiles: EC should have concluded its negotiations on major textile agreements. If they contain outward processing clause, USG must decide whether to press EC on this in the GATT.

Oct./Nov.      Unitary Taxation: Arguments before the Supreme Court. EC wants continued USG support in arguing the unconstitutionality of worldwide combined tax reporting. (Decision likely next spring.)

Oct./Feb.      Steel: Commerce determinations due for subsequently filed CVD cases on steel.

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**CONFIDENTIAL****4. GENERAL APPROACH IN RESPONDING TO THE EC**

As far as our general approach to these discussions is concerned, individual issues are dealt with in specific options papers, but a few generalizations may be useful:

1. U.S. policy should stress continuity, consistency, a low-key, action-oriented approach, and, above all, not raise expectations that cannot be fulfilled. Rather than being defensive or apologetic, we should approach the Europeans with a sincere desire to pick up their appeal for a dialogue, pointing out that this cannot focus on U.S. policies alone. We should show understanding of European concerns and their point of view.

2. We should recognize differences within the EC and work with those nations most likely to support us on individual issues (the UK and Germany on agriculture).

3. The nature of our differences with the EC does not lend itself to "trading off" across issues. However, the timing of our decision may affect the tenor of our dialogue, and, where possible, we should take this into account. Poor timing can give the appearance of a coherent anti-European policy where none exists.

4. We can address our problems in other areas more productively if we dissociate them from our differences on East-West economic relations.

In managing current issues with its European Allies, the SIG could consider the following procedural options for responding to European concerns:

1. A visible, high-level response beginning a "new dialogue."

This option could involve a variety of new steps, such as sending a Cabinet-level delegation to Europe or inviting the EC Council President to visit President Reagan, to demonstrate special sensitivity to European concerns and reinforce existing consultations and negotiations. It involves no high-level negotiations on specific issues.

2. Address key issues through existing channels with greater intensity and commitment.

This option precludes any special steps outside existing channels and ongoing negotiations but implies a commitment to pursue existing issues with greater vigor and willingness to achieve compromises based on mutual concessions.

3. Some combination of one and two above.

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This option involves special steps, perhaps including the designation of a Cabinet-level official, or officials, to carry on intensified negotiations with the Europeans designed to demonstrate and reinforce enhanced commitments to pursue solutions to issues in existing channels.

4. Pursue business-as-usual in U.S.-European economic relations.

This option involves focusing on already scheduled events and negotiations in U.S.-EC relations and pursuing these activities in line with recent levels of emphasis (e.g., pre-summit and since). No special high-level activities.

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5. OPTION PAPERS

Attached are option papers on steel, agriculture, and GATT Ministerial. The agriculture paper was prepared by Treasury after the July 27 IG meeting. It synthesizes the papers previously prepared by USDA, State and Treasury.

Attachments

JUL 25 1982

## STEEL TRADE TENSIONS BETWEEN THE U.S. AND THE EUROPEAN COMMUNITIES

### ISSUE

How to reduce tensions between the U.S. and the European Communities while providing the U.S. industry with relief from injury caused by subsidized or dumped imports.

### EC POSITION

The EC wishes to reach an overall agreement with the U.S. which would alleviate the current tensions over steel trade.

### CURRENT U.S. POLICY

The U.S. Government is actively exploring avenues of agreement with the Europeans which would eliminate injury to the U.S. industry. Barring such an agreement it is required by law to proceed with the ongoing antidumping and countervailing duty cases.

### OPTIONS

- Comprehensive EC-wide settlement. Secretary Baldrige continues his current intensive efforts to settle the steel cases through negotiations with European Commission officials.
- Completion of pending cases. If the above is not possible, the Department of Commerce has no choice under the statute but to continue the cases to their conclusion. This will probably result in the exclusion of major steel imports from France, Belgium, Italy and the United Kingdom.

### RECOMMENDATIONS

That USG seek an agreement with the EC, while simultaneously proceeding with cases.

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## DISCUSSION

### Problem

The U.S. unfair trade statutes require that, if imports are found to have been subsidized or dumped (sold below fair value) and cause injury to a U.S. industry, special duties must be levied to counter the subsidy or dumping. In 1981, certain EC steel producers openly (or through evasion) undercut the Trigger Price Mechanism, which had been set up to ward off complaints by the U.S. industry under the unfair trade laws, and rapidly expanded their sales while demand in the U.S. market was declining drastically. The U.S. industry on January 11, 1982 filed complaints under our laws. On June 10, the Commerce Department issued preliminary determinations that producers in seven EC countries are subsidized in varying amounts. Preliminary determinations are due August 9 in dumping cases covering the same EC countries and products.

Although the subsidies are widely acknowledged, and U.S. action is both required by our law and clearly permitted by international agreements, the importance of the steel industries in these EC countries means that the EC must treat the U.S. action as a major trade problem. At the same time, failure by the Administration to enforce our statutes and our rights under the international agreements could lead to domestic pressures for extreme protectionist measures by the United States.

We are intensively seeking a solution that will enable us to settle these cases prior to October 8 (the date by which, under the statute, final injury determinations in the subsidy cases must be made). Any settlement must relieve the U.S. industry of injury caused by the subsidized or dumped imports, while still providing a trade regime that will not totally eliminate major segments of U.S.-EC trade in steel.

In recent weeks Secretary Baldrige and Ambassador Brock have met with Vice President Davignon of the EC on both sides of the Atlantic to seek a resolution of the problem. After a special meeting of the EC Council of Ministers on Saturday, July 24, Davignon announced that the Council had given the EC Commission an exclusive mandate to negotiate with the U.S. Government to seek a means to alleviate the tension between us over steel trade. Preliminary discussions about suspension agreements were held last week with representatives of several EC member states, but since it has been decided to pursue a comprehensive solution these were not further pursued.

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### Background

The world steel industry has been in crisis since 1975 due to a growing structural imbalance between supply and demand and to recurrent cyclical downturns. The industry in many EC countries has adjusted poorly, relying on increasing government financial assistance rather than closing inefficient capacity and reducing its excess labor force. The West German steelmakers' trade association estimates that \$30-35 billion has been spent or is committed by governments of other EC countries for their steel industries for the period 1975 through 1983. Such levels of subsidization are forcing Dutch and German steelmakers to seek government aid to modernize and stay competitive with their heavily subsidized neighbors.

The current recession in Western Europe has cut EC steel capacity utilization to below 65%, and imports from outside of the EC now take 10% of the market.

The EC has attempted to deal with the current steel crisis by raising internal prices through coordinated cutbacks in production and employment. Continued steel subsidization has consequently become a political necessity for several governments. Nevertheless, the EC member states recognize the need to eliminate obsolete and excess capacity, and to create an industry that can compete without government assistance. The EC as a whole is committed to a State Aids Code designed to eliminate both excess capacity and subsidization in steel by the end of 1985.

The U.S. industry has adjusted somewhat better than the European industry by closing obsolete plants, reducing its labor force, and investing in modern equipment. However, high import levels, in addition to depriving the U.S. industry of sales, may have helped push prices down and thus limited the industry's ability to obtain the capital necessary for modernization. Relying on the Administration's economic recovery program, the U.S. steel industry has announced \$6.6 billion in new capital investment, but in recent months a number of those projects have been suspended as a result of declining demand, low prices, and high imports.

The U.S. industry's capacity utilization, which averaged 77.7% in 1981, is now below 45%. Over 135,000 steel workers (31% of the industry) are laid off or on short-time. Imports have reached 24% of consumption. While imports are not the industry's sole problem, failure to address the trade problem vigorously would have serious political consequences for the Administration.

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Options Available

Seek a comprehensive settlement. At this juncture, the most attractive option is to seek a comprehensive settlement of all of the cases. Without such a settlement, the existing U.S. - EC tensions over steel trade will increase. To both resolve the trade tensions and avoid long-term economic distortions, a settlement will have to take into account the EC commitment to progressive elimination of subsidization of its steel industry and the legal right of the U.S. industry to enforcement of our unfair trade laws.

In the EC view, a settlement should permit limited U.S. sales by all EC producers while giving the EC time to eliminate subsidization through enforcement of its State Aids Code. The U.S. industry will insist, in accordance with its legal rights, that any settlement relieve it of injury caused by dumped or subsidized imports. Any settlement that did not relieve that injury would probably not survive a court test, and could lead to protectionist trade legislation.

Proceed with the cases. If a settlement cannot be reached, we will have no choice under U.S. law but to proceed with the cases. This would further strain relations between the EC countries and the U.S., while perhaps not relieving the problems of the U.S. industry (since other sources of imported steel -- including some relatively unsubsidized EC countries -- may quickly replace those countries excluded by our findings).

**CONFIDENTIAL**U.S.-EC AGRICULTURAL TRADEIssue

How to address the serious controversy between the U.S. and the EC on agricultural trade.

EC Position

The Europeans view U.S. objections to their subsidized export policy as an attempt to destroy the CAP, a cornerstone of European unity, and contrary to explicit GATT provisions permitting export subsidies on agricultural products. They view the tone of U.S. rhetoric as offensive and a dramatic shift from previous assurances not to attack the CAP. Despite considerable differences within the Community over the direction and cost of the CAP in recent years, Brussels has shown no willingness to be more flexible. Instead they point to U.S. interference in the market through import quotas and threats to subsidize U.S. exports of surplus dairy and other products. And they charge U.S. insensitivity to EC needs to curb imports of feedgrain substitutes and oilseeds.

Current U.S. Policy

The European Community's system of high agricultural support prices, variable levies on imports, and export subsidies has resulted in distortions to trade which cause U.S. farmers to lose sales in international markets, reducing potential U.S. farm income, exports and GNP.

U.S. policy has been to defend vigorously our GATT rights on agricultural trade and to urge reform of the CAP away from unlimited production and subsidized exports. The Trade Policy Committee in 1981 endorsed a comprehensive strategy to deflect the EC from its agricultural trade practices, stepping up our GATT challenges, strengthening the multilateral trading framework on agriculture and, when the climate is right, seeking EC agreement to restrain or eliminate objectionable EC practices. It also approved a vigorous stance against any new EC import restrictions (e.g., on corn gluten or vegetable oils).

Options

Option 1: Avoid further confrontation, minimizing further challenges to EC trading practices, accepting whatever concessions can be obtained without major U.S. concessions.

Option 2: Negotiate to mutually reduce price supports and trade barriers and/or seek to limit the disruptive effects of export subsidization. To improve the atmosphere for negotiations, we would tone down the aggressive public rhetoric and withdraw clearly weak GATT cases. We would also insist on a meaningful work program for agriculture in the GATT Subsidies Code context.

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Option 3: Compete directly with the EC through a counter-subsidy program, possibly by challenging EC markets on dairy products, refusing to protect the EC's usual markets in food aid recipient countries, subsidizing export credit rates or extending CCC credit maturities.

#### Recommendation

USDA firmly supports Option 3; other agencies oppose this option, preferring an option 2 approach.

#### Discussion

The EC problem in agriculture is long-standing and fundamental. The U.S. has complained since 1962, but it is only in the past two years that the EC has become a net exporter competing directly with the U.S. by means of subsidy. The EC became a net exporter of grain last year. It has doubled its sugar exports in 4 years. It is the second largest exporter of poultry and of beef and veal -- all a result of export subsidies. At the current rate of expansion, the EC will surpass the U.S. in value of agricultural exports within 2-3 years.

The United States has met with the EC repeatedly at the Cabinet level over the past 15 months, with State, Commerce, Agriculture, and USTR working in close cooperation. The U.S. has six Section 301 cases in the GATT seeking relief from unfair trade practices. We also plan to seek a clarification and improvement of GATT Subsidies Code rules affecting agriculture at the November GATT Ministerial.

USDA believes that the U.S.-EC agricultural trade issue is now at a crisis point. After intensive U.S. effort in the GATT and through bilateral discussions, the Europeans show no sign of responding. USDA argues that direct head-to-head competition with the EC would not be very costly to the U.S. and is our only possible leverage to bring the EC to the negotiating table. USDA believes that we should now back up our rhetoric with positive action; unless we demonstrate our willingness to subsidize U.S. exports to match the EC, the Community will refuse to discuss agriculture meaningfully at the GATT Ministerial or anywhere else. If we take the lead, other exporting countries such as Canada and Australia might join us in pushing hard for a resolution of the EC problem. U.S. non-farm employment in processing industries will benefit from an increase in agricultural exports.

Other agencies are not convinced that we should introduce U.S. countersubsidies at this time. Most prefer further effort to reach agreement with the EC, both on the specific issues under

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GATT complaints and more broadly through mutual negotiations on support prices and/or restrictions on the use of subsidies. They fear that a countersubsidy program could be very expensive and could cost us Australian and Canadian support in seeking changes in EC policies.

The GATT now permits export subsidies on agricultural products, provided they do not result in an inequitable market share or significantly undercut prices: weak concepts that need to be strengthened and better defined. Unless we can prove EC practices violate these weak rules, unilateral EC concessions are unlikely. A broader approach would seek to negotiate improvements in these rules under the GATT Subsidies Code, but also go beyond this to address the fundamental cause of our problems: agricultural support levels. Mutual reduction of support levels would provide substantial budget savings for both the U.S. and the EC, but will be politically difficult. If this proves impossible, negotiations could focus on limiting the disruptive effect of export subsidization. This could include limits on the level of export subsidies, restrictions on the use of export subsidies for certain markets or products, or market share arrangements.

The SIG may want to recommend that further thought should be given to develop a comprehensive U.S. approach to agriculture which will:

- Impress on the EC our intent to use the GATT dispute settlement mechanism for its intended purpose and not as a hostile act;
- Seek to strengthen the hands of those countries in the EC who may share our concerns and are trying to make the CAP more rational; and
- Permit us to fully explore, without mutual hostile recriminations, the potential for serious negotiations on price support levels and current distortions to trade.

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ISSUE

For the first time since 1973, the trade ministers of the eighty-seven members of the General Agreement on Tariffs and Trade (GATT) will meet in November 1982 to examine, at the political level, the functioning of the multilateral trading system. Preparations for the meeting are being carried out in a Preparatory Committee, which is not anticipated to complete its work until just before the November meeting. In part because the meeting was an EC idea (Davignon), and in part because the specific issues to be addressed, with the exception of agriculture, are not particularly contentious ones between the U.S. and EC, with good will on both sides preparations for the Ministerial are likely to proceed on course. However, the success of the meeting will depend on and reflect our bilateral relationship with the EC and the state of global trade relations in November.

EC POSITION

The EC representative to the GATT has been instructed to "distance himself" from the Ministerial preparatory process in light of recent U.S. action in the trade field. Privately, EC officials have said that they still support the goals of the Ministerial and will work with us to ensure a successful meeting but that publicly they must maintain a more critical posture.

CURRENT U.S. POSITION

The U.S. strongly supports the Ministerial meeting. Our objectives for the meeting are to receive commitments from the trade ministers to strengthen the GATT, resist protectionism, provide a forum for the discussion of developing country trade issues, and launch a program for trade liberalization in the 1980's. This should include work on the emerging problems of trade in services, trade-related investment measures, and trade in high-technology goods.

OPTIONS

-- scale-back U.S. proposals for GATT study of trade in services, trade-related investment measures, and trade in high-technology goods;

-- resolve certain tensions in the broader GATT context (e.g., steel, Section 301 petitions, U.S.-EC GATT dispute settlement cases) with a view towards improving the tenor of EC rhetoric leading up to the Ministerial;

-- continue to press for inclusion of all U.S. proposals for the Ministerial, irrespective of the current tensions;

-- agree to drop Ministerial discussion of the problem of trade in agricultural products.

RECOMMENDATION

Initiate a dialogue with appropriate EC officials to improve the atmosphere sufficiently to promote EC cooperation in ensuring a successful Ministerial.

**DISCUSSION**

The ministerial meeting provides a prime opportunity for trade ministers to reaffirm their countries' commitment to uphold the GATT principles and strengthen the operation of the system. This session will be held during a period of strong protectionist pressures resulting in large part from the prolonged recession that has gripped member countries. Decisions taken at the Ministerial will set the course of GATT activity during the 1980's, and can determine whether the organization will continue to be a major force for trade liberalization. Given the difficult global economic situation and the increasing pressures for protectionism, the U.S. and EC, as leaders in the GATT, have an important stake in seeking agreement on how to strengthen the system.

While the U.S. has taken a much more ambitious approach to the Ministerial than the EC, discussions in the Preparatory Committee and in private conversations have revealed few substantive differences. The Community has not been thoroughly supportive of all U.S.-proposed agenda items but last week the Director-General of the GATT confirmed that the major U.S. proposals most likely will be on the agenda, including trade in services, trade-related investment measures, and trade in high-technology goods. For each of these items, the U.S. is proposing that the GATT begin to study the problems and develop an inventory of trade barriers. Option one above suggests that the U.S. scale-back these proposals in order to make them more acceptable to the EC and thereby improve overall U.S.-EC relations. This option should not be pursued since the proposals are modest to begin with and the EC has agreed, or more accurately acquiesced, to their placement on the agenda.

The few substantive differences which do exist concern issues that either are being dealt with outside the regular GATT framework or are specific bilateral issues which will not be part of the Ministerial agenda (e.g., steel, the pipeline decision and the number of U.S.-EC trade disputes currently before the GATT). To the extent that these problems can be resolved prior to the Ministerial, the chances for a productive Ministerial session will be enhanced. Option two, though not directly related to preparations for the GATT Ministerial per se, notes the spill-over effect of resolving the current bilateral trade tensions and the prospects for a successful Ministerial meeting. The details of these problems and recommended courses of action are the subjects of other SIG papers.

The third option recognizes that the preparations for the Ministerial meeting have developed a momentum of their own and are continuing in spite of the current tensions. Because we are reasonably certain of achieving our objectives for the Ministerial and have reached tacit agreement with the EC on issues of importance to us, any further modifications of the Ministerial agenda are unlikely to result in tangible improvements in our overall trade relationship with the EC. However, in order to ensure that preparations for the meeting proceed on course, and that the stage is set for the trade ministers to make concrete decisions to improve the trading system, the U.S. should initiate a dialogue with appropriate EC officials in Geneva, Brussels and Washington concerning the Ministerial.

any substantive difference is on the treatment of agricultural issues. The U.S. is a major, efficient producer of agricultural products, and therefore seeks to liberalize agricultural trade. The EC is an inefficient producer of agricultural products, and thus opposes efforts to open up trade. Our above suggests retreating from our position that the issue of trade in agriculture must be addressed at the Ministerial. Negotiations are taking place in Geneva to determine whether this issue should be framed on the agenda. It is clear that other countries, including Australia, Canada, New Zealand, and a number of developing countries, will insist that agricultural issues be discussed. Changing our position is to prevent agriculture from being placed on the Ministerial agenda. However, without strong support by the U.S., our program would not likely lead to trade-liberalizing negotiations. Further, an active agriculture program in GATT at a time when the EC is modifying the Common Agriculture Policy to prepare for Spanish accession will be helpful in minimizing the adverse effects on third countries.

High-level discussions with appropriate EC officials during the Ministerial preparations appear to be the best way to ensure that the broader tensions in the U.S.-EC relationship do not disrupt the progress anticipated from the Ministerial meeting.